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POLITICAL RESTRAINTS ON TRADE WITH THE ARABS

Investment Prospects in Saudi Arabia

*by Richard G. Buckner**

Saudi Arabia is presently the world's second largest producer of oil and has the world's largest proven oil reserves.¹ As a result, Saudi foreign exchange reserves are among the largest of any nation's and have prompted the Saudi government to adopt a five-year development plan which is, on a per capita basis, one of the most ambitious undertaken by any country. While the great influx of petrodollars makes Saudi Arabia a prime target for investors from abroad, there are numerous economic, political, legal and cultural factors to be considered before investments are made. This article will discuss these factors from a practical standpoint and outline the mechanism employed in setting up a business venture in Saudi Arabia.

Economy

Saudi Arabia is facing the limits of utilizing raw money to procure development. Money has literally been allocated to development faster than it can be spent. The major obstacles to development are inadequate port capacity and materials handling ability and a shortage of manpower.² In Jeddah, the port is so congested that arriving ships must wait from twenty to thirty-five days before unloading. One result of the delay is that shippers have added a fifty percent surcharge on shipping charges.³

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¹TIME, July 11, 1977, at 48. Saudi Arabia may overtake the Soviet Union, the number one producer, by late 1977.

²U.S. DEPT OF STATE, BACKGROUND NOTES: SAUDI ARABIA 5 (Oct. 1975).

³Ports, which recently were badly congested, are located in Jeddah, Yasha, Las Tanura and Damman. International airports are located in Jeddah, Rijadh and Dhaaa. Internal transportation in this country of about 873,000 square miles (about the size of the U.S. east of the Mississippi) consists of 357 miles of railroad and 6,200 miles of roadway. R. NYROP, B. BENDERLY, L. CARTER, D. EGLIN, R. KIRCHNER, AREA HANDBOOK FOR SAUDI ARABIA viii (3d ed. 1977). The Saudi government is planning to spend U.S. \$450 million for ports at Tuwwal and Ras al-Qar. Wall St. J., Mar. 18, 1977, at 33, col. 4.

Saudi Arabia is a member of the International Monetary Fund which controls the riyal. The riyal was worth about U.S. \$0.22 in 1972, U.S. \$0.27 in 1973, U.S. \$0.28 in 1974 and U.S. \$0.29 in 1975.⁴

The Saudi riyal is backed by a 100 percent cover of gold and convertible currencies. Saudi Arabia currently has foreign exchange reserves second only to West Germany; these reserves are expected to reach \$100 billion by 1980. No foreign exchange restrictions are imposed; foreign investors may freely repatriate profits and capital.⁵

The government's massive use of oil income for domestic development is rapidly increasing the supply of money and has fueled an inflation rate of about forty percent.⁶

Over ninety percent of government revenues come from oil company royalties and taxes. The government policy is to diversify sources of national income to reduce the heavy oil dependency. Accordingly, the five-year plan issued on May 21, 1975 envisions expenditures of about \$144 billion⁷ for development of gas gathering and treatment projects, petrochemical production, export refining, fertilizer production, manufacture of steel and aluminum, electricity, desalination, expansion of agriculture, housing, roads, telecommunications and education.⁸

The growing level of Saudi consumer affluence is creating a boom market for non-durables and a market for durables which will continue to increase for quite some time. Most manufactured goods and one-third of the Saudi food requirements are still being imported. The best U.S. possibilities in Saudi Arabia are felt to be food products, consumer goods, drugs and medicines, office and institutional equipment, cooling equipment, communications equipment, oil field equipment, motor vehicles, aircraft and equipment, consulting engineering services, construction equipment and all other capital equipment.⁹

⁴The official exchange rate varied as follows: 1972 U.S. \$1.00=SR4.55, 1973 U.S. \$1.00=SR3.73, 1974 U.S. \$1.00=SR3.55, 1975 U.S. \$1.00=SR3.49. U.S. DEPT OF COMMERCE, FOREIGN ECONOMIC TRENDS AND THEIR IMPLICATION FOR THE U.S. (Feb. 1975, June 1975). In 1975 the riyal was cut free from the dollar and is currently pegged to the IMF accounting unit which is designated as a Special Drawing Right (SDR). Wall St. J., March 17, 1975, at 15, col. 1.

⁵U.S. DEPT OF COMMERCE, OVERSEAS BUSINESS REPORTS, FOREIGN TRADE REGULATIONS OF SAUDI ARABIA (Oct. 1963); DEPT OF STATE, *supra* note 2.

⁶TIME, July 11, 1977, at 48.

⁷This figure is equivalent to about U.S. \$6,000 per person, per year. On a population comparison, this is equivalent to the United States spending about one trillion U.S. dollars per year on development. Note that the U.S. gross national product is only about 1.6 trillion dollars.

⁸U.S. DEPT OF STATE, *supra* note 2, at 5.

⁹U.S. DEPT OF COMMERCE, OVERSEAS BUSINESS REPORTS, *supra* note 5. U.S. DEPT OF STATE, *supra* note 4. Saudi Arabia is represented in the United States at its commercial office, Embassy of the Kingdom of Saudi Arabia, 1520 18th St., N.W., Washington, D.C. 20036 and at the Consulate General, Kingdom of Saudi Arabia, 633 Third Avenue, New York, N.Y. 10017. A summary of Saudi and relevant U.S. import-export restrictions is at U.S. DEPT OF COMMERCE, OVERSEAS BUSINESS REPORTS, *supra* note 5.

Expansive government development programs, together with the increasing supply of money in the private sector is creating lucrative opportunities for the construction and service industries.

The Saudi government has established an Industrial Development Fund to make essentially interest free loans of up to fifty percent of finance costs of new industry. The government is willing to assist the investor willing to make an equity commitment to Saudi industrialization through a tax holiday, cheap land and energy, no limits on repatriation of profits, and subsidized costs.

Evidently the required foreign capital investment is primarily earnest money to ensure the continued interest of the foreign investor.¹⁰ Much growth is predicted for the industries mentioned above, and particularly for the petrochemical industry. The Saudis know that a barrel of oil worth U.S. \$12 is worth U.S. \$185 after transformation into petrochemicals. The Saudis have a great deal of respect for "American know-how," primarily as a result of their experience with Aramco. Consequently, the Saudi government evidently feels that its money is better spent in attracting that "know-how" than in direct spending on industrial development. The opportunities created for petrochemicals create equally attractive opportunities for supportive industries such as construction and transportation.¹¹ Some U.S. \$27 billion worth of medium and long term contracts were awarded to U.S. firms in the past year.¹²

The opportunities for U.S. companies to engage in joint ventures for better economy and increased capacity appear to be unlimited. An example of opportunity lost was when the Saudi authorities recently appropriated money to build 100,000 homes very quickly in an attempt to remedy the critical housing situation with a hefty injection of cash. No single U.S. company could handle such a massive project and the industry was evidently unable to pull itself together to reap the bounty using a joint venture.¹³

In 1932 Abd al-Aziz Al Saud declared himself king of "the kingdom of the Arabs of the House of Saud" which is Saudi Arabia. The declaration culminated almost thirty years of struggle to unify the tribal families of Arabia. A government based on Islamic law as embodied in the Shari'ah and as interpreted by the Hanbali school was established. The king, as religious leader, is bound by the Shari'ah. No legislative department was created, legislation is by royal decree, not inconsistent with the Shari'ah. No political parties or elections are used, power passes to a successor selected, based on experience and

¹⁰FORBES, Feb. 15, 1976, at 30.

¹¹*Id.*

¹²PROGRESSIVE, April 1977, at 44.

¹³FORBES, Feb. 15, 1976, at 39.

outstanding physical and mental qualities, by the king from the royal family.¹⁴

Oil was discovered in the late 1930's and development commenced in earnest after the war. King Abd created in 1953 a Council of Ministers with power to prepare legislation for his approval and to assist in administration. Currently there are twenty such ministries.¹⁵ Abd was succeeded in 1953 by Saud ibn Abd al-Aziz Al Saud. Saudi Arabia became engaged in limited war with Egypt in Yemen in 1963 and tensions remained high until Egypt withdrew in 1967 as a result of the Arab-Israeli six day war. Saudi Arabia did not participate in the Arab-Israeli war but later agreed to provide subsidies to Egypt and Jordan to counter the effects of the war on their economies. King Saud abdicated in 1964 in favor of Faisal ibn Abd al-Aziz Al Saud.

Saudi Arabia supported the Arab cause in the 1973 Arab-Israeli war, joining the Arab oil boycott. Thereafter Saudi Arabia joined with OPEC¹⁶ to substantially increase oil prices and dramatically increase both its monetary and political power in the process. King Faisal was assassinated in 1975 and was succeeded by Khaled ibn Abd al-Aziz Al Saud.

The Saudi government is stable. The assassination of King Faisal has not had any adverse effect on the policies of the government or on the economy and none is expected.¹⁷ Saudi Arabia has close political ties with the U.S. notwithstanding the strained Arab-Israeli relations. The Saudi government reportedly has a strong antipathy for communism and is dedicated to a free economy.¹⁸

The Saudi population was recently estimated to be about 7.5 million.¹⁹ About twenty percent of that number are still nomadic. Roughly

¹⁴E. BROWN, *THE SAUDI ARABIAN KUWAIT NEUTRAL ZONE 1-20* (1963), U.S. DEPT OF STATE, *supra* note 2, at 3. The royal family currently numbers about 5000. PROGRESSIVE, April 1977, at 47.

¹⁵The ministries are as follows: in Jeddah, Ministry of Foreign Affairs; in Riyadh, Ministry of Interior, Ministry of Defense and Aviation, Ministry of Finance and National Economy, Ministry of Commerce, Ministry of Petroleum and Mineral Resources, Ministry of Labor and Social Affairs, Ministry of Education, Ministry of Information, Ministry of Communications, Ministry of Agriculture and Water Resources, Ministry of Health, Ministry of Pilgrimage and Awkaf, Ministry of Justice, Ministry of Public Works and Housing, Ministry of Planning, Ministry of Posts, Telegraphs and Telephones, Ministry of Higher Education, Ministry of Industry and Electricity, Ministry of Municipal and Rural Affairs.

¹⁶Organization of Petroleum Exporting Countries.

¹⁷U.S. FOREIGN SERVICE, U.S. DEPT OF STATE, *FOREIGN ECONOMIC TRENDS AND THEIR IMPLICATIONS FOR THE UNITED STATES* (June 1975). King Khalid is known to have a heart condition which has so concerned him that he has had an in-flight operating theatre installed in his 747. Khalid would be succeeded by Crown Prince Fahd, who is already heavily involved in running the government. Consequently, his ascension should cause no immediate change in Saudi policies. NEWSWEEK, Feb. 28, 1977, at 34.

¹⁸R. NYROP, *supra* note 3, at 219. Saudi Arabia does not recognize any communist nation. Wall St. J., Sept. 20, 1976, at 6, col. 2.

¹⁹TIME, July 11, 1977, at 48.

one-half of the work force is engaged in agricultural or other rural activities and of the remaining workers, virtually none are skilled.

Consequently, Saudi Arabia is suffering from a very severe manpower shortage. In 1974 an estimated one million non-Saudi workmen were employed in Saudi Arabia;²⁰ over one-third of the urban work force and over one-half of the workers in the Jeddah port and industrial region were non-Saudi.²¹ Indications are that between 500,000 and 1,500,000 foreign laborers will be required over the next five years if the government's current development plan is to be implemented.²²

Additionally, Saudi Arabia is suffering from a severe housing shortage. Foreign firms are being required to bring prefabricated housing for their workers.²³ Aramco is presently implementing plans to house large numbers of workers temporarily on barges docked in the Persian Gulf.²⁴

The pace of Saudi negotiation and communication is said to appear slow to a western observer.²⁵ Much time is involved in observing social amenities; the observance of traditional forms of generosity, hospitality, and social greeting is felt to be essential. Attempts at haste may be interpreted as rudeness.

Legal System

The Saudi legal system is based on the traditional law of Islam as embodied in the Shari'ah and, with regard to matters not expressly covered by the Shari'ah, on compatible royal decrees.

The Islamic religion teaches that Muhammad was the last of a series of twenty-eight prophets commencing with Ibrahim (Abraham) and including Jesus. None of the prophets were divine beings but rather were divinely inspired. The teachings of most of the prophets were corrupted over the years by their followers but were corrected by the divine inspiration of Muhammad.²⁶

The Koran is the primary source of Islamic law but the entire body of law, called the Shari'ah, includes the Koran, the Sunna (which is composed of examples of acts of the Prophet and examples of practices approved by the Prophet's knowing non-objection), the Ijma' (the consensus of the community) and the Qiyas (the method of analogy). Four

²⁰U.S. DEPT OF STATE, *supra* note 2, at 5. Presently about 30,000 Americans are working in Saudi Arabia. TIME, July 11, 1977, at 48.

²¹U.S. DEPT OF COMMERCE, OVERSEAS BUSINESS REPORTS, ESTABLISHING A BUSINESS IN SAUDI ARABIA 6 (Aug. 1970).

²²U.S. DEPT OF STATE, *supra* note 2.

²³TIME, July 11, 1977, at 48. Apartments in Jeddah rent for about U.S. \$2200 per month.

²⁴PROGRESSIVE, April 1977, at 45.

²⁵U.S. DEPT OF LABOR, BUREAU OF LABOR STATISTICS, LABOR LAW AND PRACTICE IN THE KINGDOM OF SAUDI ARABIA (BLS Report 407, 1972). Wall St. J., May 17, 1976, at 6, col. 2.

²⁶E. BROWN, *supra* note 14.

schools of approach exist to derive law not expressly set out in the Shari'ah, each based on a legal text containing opinions on various legal questions; they are the Maliki, Hanafi, Shafi'i and Hanbali Schools. Saudi Arabia officially follows the Hanbali School and Saudi jurists refer to the Hanbali legal texts for the law.²⁷

Although the Shari'ah is the source of both the purely religious and of the secular law, the two are separate and distinct, the secular law being more readily altered to implement social goals. The juxtaposition of the two systems, however, creates essentially a code of ethics, "the purpose of which is to strengthen the secular principles, by giving them a sense of dependence on divine guidance."²⁸

The king may, by decree, govern matters not covered by the Shari'ah. The decree must be compatible with the Shari'ah or it is void. Since the king is the supreme religious leader and is thus responsible for the final interpretation of Islamic law, little independent control would seem to exist. In practice, however, religious leaders and scholars are able to exert some pressure to influence the king in this regard.

The legal system of Saudi Arabia is not unable to legislate new solutions for novel problems. The Shari'ah is composed of a finite set of examples and is not expected to govern an infinite set of applications. The schools of approach mentioned above attempt to bridge this gap by using analogy with guiding principles of public interest, welfare or benefit to society and the elimination of hardships. The Hanbali school derives new judgments primarily according to the dictates of public interest and welfare.

The dictates of public interest may change or modify even an explicit principal of the Shari'ah. One theory attempting to reconcile this apparent inconsistency is that since the Shari'ah is a system based on the welfare of society, any principal which becomes unjust is not a part of the Shari'ah but rather was inserted therein by false interpretation.²⁹ Another, more widely accepted theory, is that every principal in the Shari'ah is based on custom and may be changed when the custom is changed.³⁰ Whatever the accepted rationale, there can be no doubt that the Shari'ah remains a flexible source of the law, continually changing to reflect public interest considerations.³¹ The writer is not intimating that an unstable system of jurisprudence exists in Saudi Arabia, but rather that a system capable of responding to the needs of society, not inapposite to the U.S. system of constitutional law, exists.

²⁷*Id.* The Hanbali law is set out in Mughni, which is summarized in each of the Kafi, Mugni' and 'Umdah.

²⁸Address by H. Yamani, entitled Islamic Law and Contemporary Issues, at American University of Beirut (Feb. 7, 1967).

²⁹*Id.*

³⁰*Id.* Note the similarity between this view and the doctrine of *Ratione Legis Cessante, Cessat Lex*.

³¹*Id.*

The Shari'ah guarantees the right to private "ownership" of property³² (which may not be revoked by the authorities except for public interest considerations and only for adequate compensation), freedom from unreasonable entry, search and seizure of dwellings, freedom of speech and expression,³³ freedom of religion and freedom of education.

Islamic law declares that all property is owned by God and that what belongs to God is available for the general benefit of the community. An individual may have "ownership" of property, but he holds it *in trust* with an obligation to use it for his benefit and that of the community. Consequently, if the needs of society, or those of another individual are *extreme*, the "ownership" ceases. Additionally, an individual will not be allowed to use his property to harm the community or other individuals nor will he be allowed to deny the use of his property in the face of a compelling need of others where their use would not interfere with his use. This last point is illustrated in *Al Dahak v. Mohammed Bin Muslimah*,³⁴ where an adjacent landowner was allowed to dig a channel across his neighbor's land over the neighbor's objections because the adjacent landowner needed water and the channel would not interfere with the neighbor's use of his land.

Administration of the Saudi legal system is separated into Shari'ah law and decree law.³⁵ The king acts as a final court of appeal for both branches and has the power of pardon.

The Ministry of Justice has administered the Shari'ah branch since the Ministry was formed in 1970. Since Shari'ah law is not case law, decisions, even of a higher court have no binding precedential effect. Trial by jury is not used; all decisions are made by the judges who have a reputation for incorruptibility and justice. Interpretation and enforcement of the criminal law is quite strict, with the result that the Saudi crime rate is one of the lowest in the world. The Shari'ah courts are forbidden to apply any but Islamic law; foreign judgments may not be enforced until the matter has been reconsidered under Islamic law.

The ordinary courts or courts of first instance deal with misdemeanors and small claims. The high courts of Shari'ah law deal with all other matters. Decisions of either of the lower courts may be appealed to the appeals courts. A Supreme Judicial Council supervises the court system and may hear an appeal of a serious case. The Council may not alter a verdict but may refer the case to the appeals court. Finally, as mentioned earlier, petitions of appeal may be presented directly to the king who may reverse the decision or grant a pardon.

³²See text accompanying note 37 *infra* for the extent of rights granted non-Muslim aliens.

³³See text accompanying note 49 *infra* for limitation on speech of foreign investors.

³⁴H. Yamani address, *supra* note 28.

³⁵See R. NYROP, *supra* note 3, at 188-91. See also E. BROWN, *supra* note 14 and H. Yamani address, *supra* note 28.

Violations of and disputes under decree law are handled in administrative courts under the relevant ministries. For example, labor disputes and violations of the labor laws are handled by the Ministry of Labor and Social Affairs, commercial disputes and violations of the companies' regulations are handled by the Ministry of Commerce. Appeals may be had from the administrative courts to appeals boards and finally to the Grievance Board which is directly answerable to the Council of Ministers.

Saudi Arabia joined the United Nations as a charter member and is a member of the International Court of Justice, although it has never declared itself subject to compulsory jurisdiction of the court. Saudi Arabia entered into an agreement with the U.S. in November of 1933 in which Saudi Arabia agreed to treat U.S. nationals in accordance with international law and no less favorably than nationals of other countries.³⁶ The U.S. Consular Office in Saudi Arabia offers the protection of the consular officers to ensure that arrested Americans receive justice at least equal to what a Saudi national would receive.³⁷ U.S. nationals are subject to Islamic law in the Saudi courts.

Traditionally, the Christian or Jewish resident of Saudi Arabia had certain disabilities; for example, he could not marry Muslim women, could not acquire or hold land, would receive less than would a Muslim in a tort suit, and although he could enter into a partnership with a Muslim, the partnership had to be controlled by the Muslim. On the other hand, the Christian or Jewish resident was not subject to the same laws; for example, he could engage in usury.³⁸

Although this traditional distinction has evidently been extensively altered,³⁹ the foreigners should note that the traditional "code of ethics" which has surrounded commercial dealings between Muslims has never been felt to extend to Christians and Jews. It seems unlikely that this code, which is based on the Islamic religion, has been altered and thus the foreign investor should follow the admonishment of *caveat emptor*.

*Commercial Laws and Foreign Investment Impact*⁴⁰

Foreign investors must apply to the office of Foreign Capital Investment of the Ministry of Commerce in Riyadh for permission to invest foreign capital pursuant to the Foreign Capital Investment

³⁶E. BROWN, *supra* note 14, at 20.

³⁷Letter from U.S. Consular Office to American Citizens entering Saudi Arabia, undated.

³⁸E. BROWN, *supra* note 14, at 22.

³⁹For example, under a Royal Decree of 1390 foreigners may acquire land under certain circumstances, a foreign partner may control a partnership with a Muslim.

⁴⁰This article does not investigate the requirements and applicable laws for investment in the banking, petroleum and mineral extractions industries.

Code.⁴¹ Official applications must be in Arabic and must contain complete data about the investor, a list of items to be produced or sold, statistics on current Saudi production of those goods, a description of the manufacturing process, estimates of raw material, manpower and machine requirements, plans to train Saudi workers, the total value of the project, working capital requirements, feasibility studies, salary estimates, marketing programs, and copies of existing contracts between the investor and Saudi Nationals.⁴²

The application is reviewed by a "special committee concerned with the investment of foreign capital." A substantial degree of discretion is granted to the Saudi officials in reviewing the application and the amount of time involved has been known to exceed two years.⁴³ In order to facilitate foreign investment, the Saudi government's present practice is to allow foreign investors to enter into an agreement of association with a Saudi "partner" prior to approval of the application.⁴⁴ Available agents may be located by contacting one of the Saudi chambers of commerce.⁴⁵ The new company, via the Saudi "partner," may then begin operations before a permit is issued. The legal status of the operation is that of the Saudi "partner" who obtains work and residence visas for the necessary foreign personnel and who formally concludes contracts which may later be assigned when the new company actually comes into existence.⁴⁶

On approval of the application to invest, the investor will become entitled to an industrial license⁴⁷ and may become entitled to investment incentive benefits.⁴⁸ The foreign investor is required to comply with all labor, inspection and control regulations, and is required to refrain from interfering or concerning himself in any way with Saudi

⁴¹Foreign Capital Investment Code, enacted by Royal Decree No. 35 of 11 Shawal 1383 (1964).

⁴²OVERSEAS BUSINESS REPORTS, *supra* note 21, at 3. Application forms in Arabic are available from the Ministry of Commerce, Riyadh; English versions are available from the Near East-South Asia Division of the U.S. Dep't of Commerce, Washington, D.C. 20230.

⁴³Letter from Alan Jones of Arabian Business & Management Services which is preparing monographs to be published by Westview Press of Boulder, Colorado, concerning the Saudi Industrial Development Fund, corporate taxation and regulations for companies including an analysis of the differences between Saudi law as written and as applied.

⁴⁴*Id.*

⁴⁵Chambers of Commerce are located at the following addresses: Khazan St., P.O. Box 596, Riyadh; Kabel St., P.O. Box 1264, Jeddah; P.O. Box 719, Damman; P.O. Box 1086, Mecca; P.O. Box 443, Medina.

⁴⁶Letter from Alan Jones, *supra* note 43.

⁴⁷For sample application for industrial license, see INDUSTRIAL STUDIES AND DEVELOPMENT CENTER OF SAUDI ARABIA, GUIDE TO INDUSTRIAL INVESTMENT IN SAUDI ARABIA 105 (1974).

⁴⁸See text accompanying note 54 *infra*.

religious or political affairs.⁴⁹ Violation of any of these terms will precipitate a warning or complete liquidation of the enterprise.⁵⁰

The investor may form a Saudi company⁵¹ or form a branch composed entirely of Saudi nationals or Saudi companies.⁵² The company must then register with the Companies' Register at the Department of Companies, with the Commercial Register, with the General Organization for Social Insurance, with the Ministry of Labor and Social Affairs and with the Department of Zakat and Income Tax.

Foreign workers may be employed only if such workers possess vocational skills or education qualifications needed by Saudi Arabia because of unavailability of nationals with such qualifications. Additionally, the foreign worker must be either under contract with and guaranteed by a company licensed to operate in Saudi Arabia, guaranteed by a Saudi national, or be a member of a liberal profession. The number of foreign workers may not exceed twenty-five percent of the total although this requirement may be waived temporarily by the Ministry of Labor and Social Affairs.⁵³

The Ministry of Commerce is given authority to cause the Ministry of Foreign Affairs and the Ministry of the Interior to issue the necessary entry and exit visas and residence permits for the investor and his employees. Work permits are obtained from the Ministry of Labor and Social Affairs under a new procedure allowing the permits to authorize a specific number of expatriates instead of being prepared for specific individuals.

Foreign investors qualifying for incentive benefits under the Foreign Capital Investment Code⁵⁴ may be given a limited exemption from income tax and may be granted other favorable privileges otherwise available only to Saudi investors.

Whether an investor is entitled to the incentive benefits is determined by the Ministry of Commerce on the recommendation of a "special committee concerned with the investment of foreign capital."⁵⁵ The committee's recommendation is based on an *in camera* examination of the application for permission to invest foreign capital.⁵⁶

⁴⁹Foreign Capital Investment Code, *supra* note 41.

⁵⁰*Id.* art. 12.

⁵¹See text accompanying note 74 *infra*.

⁵²Agencies of foreign firms in Saudi Arabia are restricted to nationals and Saudi companies which must be wholly national in terms of capital, officers and authorized signatories. Royal Decree No. 11 of 1382 (1963).

⁵³Labor and Workmen Law, enacted by Royal Decree No. 20 of 6 Ramadan 1389 (1969), arts. 45 & 49.

⁵⁴Foreign Capital Investment Code, *supra* note 41.

⁵⁵*Id.* arts. 2(b), 5, 6.

⁵⁶*Id.* arts. 3, 5. See text accompanying note 41 *supra*.

The application must establish that the foreign investor intends to invest foreign capital⁵⁷ in an "economic development project." The term "economic development project" is not defined in the Decree but has been said to include only investments in industrial manufacturing.⁵⁸ Evidently some construction contractors have been allowed to qualify provided the level of Saudi capital participation was at least fifty percent.⁵⁹ The government's stated goals in offering incentives for industrial development are to increase national income, to reduce the effect of outside economic disturbances by diversification, to raise the standards of living and employment, and to increase the abilities and technical capabilities of the people.⁶⁰ The investor would be wise to couch his petition for incentive benefits in terms of as many of these stated objectives as possible.

If the investor is found to be entitled to the incentive benefits and if the participation of Saudi capital is not less than twenty-five percent of the total, the entire project is exempted from income tax for a period of five years from the commencement of production.⁶¹ Note that the level of Saudi participation must not drop below twenty-five percent during the period of exemption. The U.S. investor will note that because of the U.S. foreign tax credit,⁶² the rate of Saudi income tax may not affect the investor's overall tax burden to the extent the Saudi operations are also subject to U.S. taxation.⁶³ Thus the exemption from Saudi taxation may be of no net value to the investor.⁶⁴

Additionally, the investor qualifying for incentive benefits is entitled to all privileges accorded Saudi investors under the Ordinance for Protection and Encouragement of National Industries. Such privileges are available only to industrial establishments engaged in either the

⁵⁷Foreign capital is defined as any capital "owned by a natural or corporate person who does not enjoy the Saudi Arabian nationality." *Id.* art. 1.

⁵⁸PEAT, MARWICK, MITCHELL & CO., TAXATION AND OTHER COMMERCIAL LEGISLATION IN THE KINGDOM OF SAUDI ARABIA 13 (1976). Projects of the petroleum or mining industry are specifically excluded. Foreign Capital Investment Code, *supra* note 41, art. 2(a).

⁵⁹PEAT, MARWICK, MITCHELL & CO., *supra* note 58, at 13.

⁶⁰ROYAL EMBASSY OF SAUDI ARABIA, INDUSTRIALIZATION OF SAUDI ARABIA 8 (April, 1976).

⁶¹Foreign Capital Investment Code, *supra* note 41, art. 8(b). Both the required percentage of Saudi participation and the term of the exemption are under review for possible change. Letter from Alan Jones, *supra* note 43.

⁶²I.R.C. §§901, 902.

⁶³See text accompanying note 264 *infra*.

⁶⁴Although the foreign tax credit provisions of the Internal Revenue Code were intended to enhance foreign investment, they may act to chill the effect of a foreign investment incentive plan based on tax reductions. Seeking to remedy this anomalous situation, several commentators have unsuccessfully advocated the adoption of the "tax sparing" provisions which would allow the investor to take as a credit against his U.S. tax amounts which would have been paid to the foreign country had they not been reduced by an investment incentive program. H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS 1125 (2d ed. 1976).

conversion of raw or semi-manufactured materials into semi or completely manufactured materials or the packaging of manufactured materials.⁶⁵ The establishment must agree to allow inspection by officials of the Ministry of Commerce and must agree to employ only Saudi workers and technicians.⁶⁶ Prior approval of the Ministry of Labor and Social Affairs is required for partial waiver of the latter requirement.

The privileges offered include duty-free importation of machines, tools, appliances and spare parts necessary for the manufacturing process,⁶⁷ and of raw or semi-manufactured materials when such are found by the Ministry of Industry and Electricity to be unavailable in Saudi Arabia.⁶⁸ Land is available at a nominal rental⁶⁹ for the construction of factories and personnel houses in specified industrial districts.⁷⁰ Additionally, a Royal Decree may be granted to allow a specific industrial establishment to export their products duty free and to protect the establishment by limiting competing foreign imports, by raising the customs duties on the same, or by granting direct financial assistance.⁷¹ The investor is cautioned to consider the impact of the U.S. antitrust laws before bargaining for or accepting the available benefits.⁷²

One other practical investment incentive for the American investor is the program instituted by the Saudi-controlled Aramco, which is organizing efforts to supply labor from other countries to keep foreign firms from competing in the limited domestic labor market. They also have plans to build and operate labor camps to house the workers and have begun stockpiling machinery and building materials (imported duty-free with no delay for customs inspections) in order to keep current construction underway, lower the risks taken by U.S. contractors, and, in the long run, save money for the Saudi Arabian government.⁷³

⁶⁵Protection and Encouragement of National Industries Act, approved by Royal Decree No. 50 of 23/12/1381, art. 1.

⁶⁶*Id.* art. 10.

⁶⁷*Id.* art. 4.

⁶⁸*Id.* art. 5. See INDUSTRIAL STUDIES AND DEVELOPMENT CENTER OF SAUDI ARABIA, *supra* note 47, at 127, for a sample application for import duty exemption.

⁶⁹A nominal rental has been defined as SR 0.08 per square meter per year, for the first twenty-five years. *Id.* at 64.

⁷⁰Protection and Encouragement of National Industries Act, *supra* note 65, art. 6. Industrial parks are being created in Jeddah, Riyadh and Damman.

⁷¹*Id.* arts. 7, 8. General Motors' request for a twenty-five percent protective tariff was recently denied. The Saudi Government is, however, offering GM a subsidy of U.S. \$100 million a year. FORBES, Feb. 15, 1976, at 32.

⁷²See text at notes 159-61, *infra*.

⁷³FORTUNE, Sept. 1976, at 188.

Prior to the enactment of the Regulations for Companies in 1965,⁷⁴ the official Saudi business organization was based solely on the Shari'ah. The Sunnah contains references to the Prophet consenting to partnership arrangements when he "was sent to the people." Additionally, Saudi partnerships have existed for centuries without objection and thus are a part of Ijam'.⁷⁵ The need for more specific regulations became apparent during the economic growth of the fifties and sixties and a Royal Decree for their preparation was issued.

The resulting regulations are based primarily on the Napoleonic code and are similar to those of the Western European mainland countries.⁷⁶ Since the Shari'ah is immutable,⁷⁷ the regulations permit nothing which is inconsistent with the Shari'ah and assert the right of individuals to establish traditionally recognized companies notwithstanding the regulations.⁷⁸

The regulations describe the permissible forms of company organization in detail, and companies which fail to assume one of the forms approved by either the regulations or the Shari'ah are declared null and void.⁷⁹ All of the forms of organization permitted by the regulations are included in the generic term "Sharikat."⁸⁰ The Saudi authorities have accepted interpretations of the term as either "partnership" or "company."⁸¹ The investor is thus free to select between the two in his English translations, but he would be wise to consider the different impressions which may be created in the minds of the U.S. authorities by the two terms.⁸²

A company formed under the regulations must establish its head office in Saudi Arabia.⁸³ The company is deemed to have Saudi nationality but may not necessarily enjoy rights restricted to Saudis. Except for "joint adventures," the company is not valid vis-a-vis third parties until the memorandum of association⁸⁴ is recorded in writing

⁷⁴Regulations for Companies, approved by Council of Ministers Decision No. 185 of 17 Rabi'l, 1385 (15 July 1965), enacted by Royal Decree No. M6 of 22 Rabi'l, 1385 (20 July 1965).

⁷⁵*Id.* explanatory memorandum appendix.

⁷⁶Letter from Alan Jones, *supra* note 43.

⁷⁷E. BROWN, *supra* note 14, at 10 (1963).

⁷⁸Regulations for Companies, *supra* note 74, arts. 2, 229, 230.

⁷⁹*Id.* art. 2.

⁸⁰Sharikat is the form of organization permitted by the Shari'ah.

⁸¹Letter from Alan Jones, *supra* note 43.

⁸²Consider, for example, the different impressions created when "Sharikat that Massouliyyah Mahdoodah" is interpreted as "limited liability company" and "limited liability partnership." As is discussed *infra*, the organized form is far more like the U.S. corporation than the U.S. limited partnership.

⁸³Regulations for Companies, *supra* note 74, art. 14.

⁸⁴The memorandum of association is described for general partnerships at art. 22, for limited liability companies at art. 161, for cooperative companies at art. 199 but is not specifically defined for joint-stock companies or partnerships limited by shares.

before a registrar⁸⁵ and is published⁸⁶ in either the Official Gazette⁸⁷ or the daily newspaper where the head office is located.⁸⁸ Additionally, the company is required to register with the Companies Register and with the Commercial Register.⁸⁹

After formation, the company must state on all contracts, receipts, notices or other documents the name and type of company, location of the head office, and for all companies except general and limited partnerships, the amount of authorized and paid-in capital.⁹⁰

The regulations also provide for reorganizations,⁹¹ mergers,⁹² dissolutions and liquidations.⁹³ Comprehensive penalties are provided for failure to comply with the regulations⁹⁴ and a commission is established to settle disputes and administer the penalties.⁹⁵

A foreign company⁹⁶ must either form a new company under the regulations⁹⁷ or obtain prior permission from the Ministry of Commerce to establish a branch, agency or office in Saudi Arabia to represent them.⁹⁸ Agencies of foreign firms in Saudi Arabia are restricted to Nationals and Saudi Arabian companies which are wholly national in terms of capital, officers and authorized signatories.⁹⁹

The limited liability company¹⁰⁰ involves at least two, but not more than fifty, partners, or shareholders as they may be called, who are liable only to the extent of their capital contributions.¹⁰¹ It is the most common form of business organization established in Saudi Arabia by foreign investors¹⁰² and for that reason is discussed here in greater detail.

⁸⁵*Id.* art. 10.

⁸⁶*Id.* art. 11.

⁸⁷*Id.* art. 164 (limited liability companies), 155 (partnerships limited by shares), 65 (joint-stock companies), 200 (cooperative companies).

⁸⁸This option is available for general and limited partnerships. *Id.* arts. 21, 39(2).

⁸⁹*Id.* arts. 21, 39(2), 65, 155, 164, 200.

⁹⁰*Id.* art. 12.

⁹¹*Id.* arts. 210-212.

⁹²*Id.* arts. 213-215.

⁹³*Id.* arts. 216-226.

⁹⁴*Id.* arts. 229-231. For example, failure to include necessary information on company documents may cause the offender to be subjected to a fine of up to SR 20,000 or a year in jail or both. *Id.* art. 229.

⁹⁵*Id.* art. 232.

⁹⁶*Sharikat Ahnabiyya. Id.* arts. 227-228.

⁹⁷*Id.* art. 227.

⁹⁸*Id.* art. 228.

⁹⁹Royal Decree No. 11, *supra* note 52.

¹⁰⁰*Sharikat that Massouliyyah Mahdoodah. Regulations for Companies, supra* note 74, arts. 157-180. Also interpreted as limited liability partnerships and limited companies.

¹⁰¹*Id.* art. 157.

¹⁰²Letter from Alan Jones, *supra* note 43.

The limited liability company is formed by drafting a memorandum of association,¹⁰³ collection and deposit of all contributions,¹⁰⁴ and publication of the memorandum of association in the Official Gazette.¹⁰⁵ The company will not be valid vis-à-vis third parties¹⁰⁶ nor will the bank release the capital contributions until proof of publication has been presented.¹⁰⁷ The memorandum of association must contain the following:¹⁰⁸

1. The name (there are no restrictions on the name¹⁰⁹), object (the object may not be the conduct of insurance, savings or banking operations¹¹⁰) and the location of the head office (the head office must be located in Saudi Arabia¹¹¹) of the company;
2. The names, residence addresses, occupations, and nationalities of the parties;
3. The names of the managers (who administer the company¹¹²) and whether they are partners or non-partners; alternatively, the managers may be appointed by a separate contract subsequent to the memorandum of association; if more than one manager is or is to be appointed, the memorandum must state the manner in which the managers shall operate;¹¹³ once appointed, the managers may not be removed without legal justification;¹¹⁴
4. The names of the members of the board of controllers, if any; a board of controllers composed of at least three partners to supervise the manager is required if there are more than twenty partners;¹¹⁵
5. The amount of capital and the amount of contributions in cash and in kind; the minimum capital is SR 50,000;¹¹⁶
6. A statement that all capital shares have been allotted and paid up in full;
7. The method of distribution of profits; ten percent of net profits must be set aside each year to build a reserve fund until the fund equals one-half of the capital;¹¹⁷

¹⁰³Regulations for Companies, *supra* note 74, art. 161.

¹⁰⁴*Id.* art. 162.

¹⁰⁵*Id.* art. 164.

¹⁰⁶*Id.* art. 163.

¹⁰⁷*Id.* art. 162.

¹⁰⁸*Id.* art. 161.

¹⁰⁹*Id.* art. 160.

¹¹⁰*Id.* art. 159.

¹¹¹*Id.* art. 14.

¹¹²*Id.* art. 167.

¹¹³*Id.*

¹¹⁴*Id.* art. 168.

¹¹⁵*Id.* art. 170.

¹¹⁶*Id.* art. 158.

¹¹⁷*Id.* art. 176.

8. The dates of commencement and expiration of the company; note that the company is set up for a fixed term of years;
9. The form of notices to be served by the company on the partners.

Shares are of equal value, indivisible and may not be represented by negotiable securities.¹¹⁸ Partners may assign their interests in accordance with the company's memorandum of association but each partner has the right of first refusal.¹¹⁹ Partners meetings are held at least annually.¹²⁰ Company auditors must be licensed to operate in Saudi Arabia.¹²¹

The limited liability company is dissolved on the expiration of its term or on the transfer of all shares to a single partner¹²² but unless the memorandum of association provides otherwise, the company is not dissolved by the withdrawal, incapacity, bankruptcy or insolvency of its partners. If at any time the companies' losses total three-fourths of its capital, the partners must meet to decide whether to continue or to dissolve the company.¹²³ The resulting resolution must be published in the Official Gazette.

A general partnership¹²⁴ is similar to the common law organization of the same name. It is composed of two or more persons, each jointly and severally liable for the debts of the partnership to the extent of their entire fortunes. A partnership interest may not be represented by negotiable warrants and may not be assigned without the consent of all partners. The name must include that of one or more partners but any outsider who allows his name to be used by the partnership shall become personally liable for partnership debts.¹²⁵ Unless the memorandum of association specifies otherwise the partnership is dissolved on the death, legal incapacity, withdrawal or bankruptcy of any partner.¹²⁶

A limited partnership¹²⁷ involves two classes of partners, at least one general partner who is liable for the partnership debts to the extent of his fortune and at least one limited partner who is liable only to the extent of his capital contribution.¹²⁸ The names of limited partners

¹¹⁸*Id.* art. 158.

¹¹⁹*Id.* art. 165.

¹²⁰*Id.* art. 174.

¹²¹*Id.* arts. 169, 130.

¹²²*Id.* arts. 161(8), 179, 147.

¹²³*Id.* arts. 178, 180.

¹²⁴Sharikat Tadhamon. *Id.* arts. 16-35. Also interpreted as joint liability partnership.

¹²⁵*Id.* arts. 16, 17, 18.

¹²⁶*Id.* art. 35.

¹²⁷Sharikat Tawsiyah Baseetah. *Id.* arts. 36-39. Also interpreted as mixed liability partnership.

¹²⁸*Id.* art. 26.

need not be disclosed, and if a limited partner allows his name to be used in the partnership name or if he interferes with the "external acts of management,"¹²⁹ he will incur the same liability as would a general partner. Otherwise, provisions for name, assignment of interests and dissolution are the same as for general partnerships.¹³⁰

A partnership limited by shares¹³¹ involves two classes of partners; at least one general partner who is liable to the extent of his fortune and at least four limited partners who are liable only to the extent of their capital contributions. This type of company is managed by the general partners under the supervision of a board of at least three controllers set by the limited partners. The minimum capitalization is SR 100,000 and negotiable indivisible shares of equal par value not less than SR 50 are issued. Standard bylaws are required as issued by the Minister of Commerce. Provision for name, dissolution and limitations on interference with "external acts of management" by limited partners are the same as for limited partnerships.¹³²

A joint-stock company¹³³ involves at least five shareholders who are liable only to the extent of their capital contributions.¹³⁴ This type of company is much like the U.S. corporation but is not widely used¹³⁵ because it may be formed only by Royal Decree on advice of the Council of Ministers.¹³⁶

This joint-stock company is managed by a board of at least three directors,¹³⁷ each of whom owns more than 200 shares of stock, who are liable to the shareholders for the commission of wrongful acts and who are agents of the company and who may therefore bind the company.¹³⁸ The minimum capitalization is SR 1,000,000 if the shares are to be offered for public sale, otherwise the minimum is SR 200,000.¹³⁹ The company is authorized to issue negotiable indivisible shares at a par value not less than SR 50 but the shareholders must either limit subscription for all stock to themselves or offer the balance for public subscription.¹⁴⁰ Annual shareholder meetings are required and financial statements must be published prior to that meeting.¹⁴¹

¹²⁹*Id.* arts. 37, 38.

¹³⁰*Id.* arts. 37, 39(1), 39(5).

¹³¹Sharikat Tawsiyah Bel-as-ham. *Id.* arts. 149-156.

¹³²*Id.*

¹³³Sharikat Al-Mosshamah. *Id.* arts. 48-148. Also interpreted as corporation.

¹³⁴*Id.* art. 48.

¹³⁵Letter from Alan Jones, *supra* note 43.

¹³⁶Regulations for Companies, *supra* note 74, art. 52.

¹³⁷*Id.* art. 66. Also interpreted as managers.

¹³⁸*Id.* arts. 68, 75-78.

¹³⁹*Id.* art. 49.

¹⁴⁰*Id.* arts. 48, 49, 54-57, 98.

¹⁴¹*Id.* arts. 84, 89.

A joint adventure¹⁴² is an entity which remains anonymous to third parties.¹⁴³ A third party may have recourse only against the partner with whom he has dealt unless the partners disclose the existence of the adventure in which case the adventure is considered a *de facto* general partnership in regard to the third party.¹⁴⁴ Provisions for dissolution are the same as for general partnerships.¹⁴⁵

A cooperative company¹⁴⁶ is a particular type of joint-stock or limited liability company¹⁴⁷ which is formed by a decision of the Ministry of Commerce¹⁴⁸ for the purpose of reducing cost, reducing purchase or sale prices or improving the quality of certain products or services.¹⁴⁹ Evidently, in practice the cooperative company is similar to the U.S. charitable organization because members or shareholders are entitled to receive only a portion of the net profits equal to some percentage of the paid-in capital. This percentage must be approved by the Minister of Commerce and may not exceed six percent. All other profits are either immediately allocated for assisting other cooperative companies, directed toward services of public benefit or retained as reserves and, on dissolution, they are disbursed for the same charitable purposes.¹⁵⁰

Trade Regulation

The Saudi economy is based on competition among private commercial and industrial enterprises.¹⁵¹ However, while the value of free competition is recognized, the Statement of Industrial Policy requires "competition serving the interests of local consumers" and cautions that the "Government will not permit harmful foreign competition, such as dumping."¹⁵² The government will impose quantitative restrictions or price controls as required in monopolistic or other situations "in which competition cannot have an effective role."¹⁵³

The Council of Ministers recently charged that "some companies are teaming up in bids for certain projects in an attempt to exaggerate their cost estimates."¹⁵⁴ The Council noted that a number of such

¹⁴²Sharikat Mahassah. *Id.* arts. 40-47. Also interpreted as joint ventures.

¹⁴³*Id.* art. 40.

¹⁴⁴*Id.* art. 46.

¹⁴⁵*Id.* art. 47.

¹⁴⁶Sharikat Taawoniyya. *Id.* arts. 189-209.

¹⁴⁷*Id.* art. 189.

¹⁴⁸*Id.* art. 199.

¹⁴⁹*Id.* art. 189.

¹⁵⁰*Id.* arts. 205, 207, 209. Retained reserves do not increase paid-in capital and therefore the retention of reserves will not serve to increase the profit distributable to the shareholders. *Id.* art. 208.

¹⁵¹ROYAL EMBASSY OF SAUDI ARABIA, INDUSTRIALIZATION OF SAUDI ARABIA, *supra* note 60, at 8.

¹⁵²*Id.*

¹⁵³*Id.* at 10.

¹⁵⁴Wall St. J., Feb. 24, 1977, at 6, col. 4.

international bids had already been cancelled and that the companies involved would be prohibited from conducting any business in Saudi Arabia.

It is illegal to conspire to stop means of transportation, postal, telegraph or telephone communications or any public utility.¹⁵⁵ It is illegal for an employer or employee to stop work "with the object of exerting pressure on public authorities or of protesting against a decision or measure adopted by such authorities."¹⁵⁶

No express antitrust laws have been promulgated but the King has implicit authority to proscribe practices which are not in the communities' best interests. Because a system of antitrust laws deals directly with the conflict between an individual's property rights and the interests of society, an understanding of the concept of individual property right is essential to an understanding of the antitrust system.¹⁵⁷ As has been discussed earlier, the Islamic concept of individual ownership is that an individual holds property *in trust* for God, as manifested in the community.¹⁵⁸ The trust is violated when a property right is exercised so as to cause a general injury to the community, such as would result from a monopoly or a restraint of trade.

This limitation may be tougher than that imposed by U.S. antitrust laws; for example, if the community were harmed by a restraint of trade, no finding of conspiracy or agreement would be required for a violation. The investor should examine his planned actions for possible long or short range harm to the Saudi community. Consultation with a Saudi attorney who is familiar with the Islamic law is especially important in this regard.

The U.S. antitrust laws¹⁵⁹ prohibit restraint of trade or commerce with foreign markets. Accordingly, the U.S. investor should avoid activity in foreign markets which might have the effect of foreclosing or restraining commerce between the foreign market and other U.S. investors.

The possible antitrust ramifications of bargaining for and accepting investment incentives¹⁶⁰ which may act directly to restrain the Saudi market for other U.S. investors¹⁶¹ are beyond the scope of this article.

¹⁵⁵Labor and Workman Law, *supra* note 53, art. 189.

¹⁵⁶*Id.* art. 191.

¹⁵⁷See text accompanying note 34 *supra*.

¹⁵⁸H. Yamani address, *supra* note 28.

¹⁵⁹15 U.S.C. §§ 1-77 (1970).

¹⁶⁰See text accompanying notes 54-72 *supra*.

¹⁶¹For example, the limitation of competing imports or the increase of import duties on the same.

Labor Law

The Labor and Workmen Law¹⁶² is a comprehensive plan intended to develop and protect the Saudi work force by providing for inspection of working conditions, wages, hours, health and safety measures, by establishing a minimum level of participation by Saudi workmen and by requiring in-service technical training.¹⁶³ The Minister of Labor and Social Affairs is charged with implementing the law through labor offices established in the major Saudi cities. The Minister is given authority to promulgate additional rules as needed¹⁶⁴ and is given broad inspection rights.¹⁶⁵

The employer is required to assist in implementation by appointing a resident partner or manager to be responsible for any violations of the labor law,¹⁶⁶ by posting a detailed list of the terms of employment,¹⁶⁷ and by submitting initial¹⁶⁸ and annual reports¹⁶⁹ in Arabic to the Ministry.

The regulations apply to "any contract under which any person undertakes to work for the account of an employer under the latter's direction or control in consideration of a wage." Only very limited exceptions are granted and the regulations may not be waived by contract, agreement, concession agreement or otherwise.¹⁷⁰

Although no provisions expressly prohibit the employer from discriminating in employment practices, the Saudi national is said to have a right to work¹⁷¹ which presumably may be enforced. While women are officially to be accorded employment opportunities equal to men, this is not in accordance with traditional Islamic law and custom. Consequently, women are usually still excluded from the workforce and it appears unlikely that employment of women will increase rapidly.¹⁷² Employers may be required to employ disabled workmen who have been vocationally rehabilitated.¹⁷³ Employment of foreign workers is limited by restricting their use when adequate Saudi help is available¹⁷⁴ and by limiting their numbers and wages.¹⁷⁵

¹⁶²Labor and Workman Law, *supra* note 53.

¹⁶³See BUREAU OF LABOR STATISTICS, *supra* note 25.

¹⁶⁴Labor and Workman Law, *supra* note 53, art. 209.

¹⁶⁵*Id.* arts. 22-38.

¹⁶⁶*Id.* art. 11.

¹⁶⁷*Id.* art. 9. This posting is required only for employers of more than twenty employees. *Id.*

¹⁶⁸*Id.* art. 18.

¹⁶⁹*Id.* art. 43.

¹⁷⁰*Id.* arts. 2, 3, 6. Workers in purely family enterprises, domestic servants, and some agricultural workers are excepted. *Id.* art. 3.

¹⁷¹*Id.* art. 48.

¹⁷²PROGRESSIVE, Sept. 1977, at 44.

¹⁷³Labor and Workman Law, *supra* note 53, art. 54.

¹⁷⁴*Id.* art. 48. See text accompanying note 53 *supra*.

¹⁷⁵*Id.* art. 45.

Wages¹⁷⁶ may be established by contract¹⁷⁷ but "except within the limits dictated by the need to attract foreign workmen," foreign workmen are not to be paid more than Saudi workmen of equal qualifications.¹⁷⁸ Additionally, the wages of Saudi workmen may not be less than fifty-one percent of the total wages paid by the employer.¹⁷⁹

Work hours are from 8:30 A.M. - 1:30 P.M. and then 4:30 P.M. - 8:00 P.M. Saturday through Thursday.¹⁸⁰ Friday is a holiday with full pay.¹⁸¹ During the month of Ramadan, work hours are reduced to 9:00 A.M. - 2:00 P.M.¹⁸² although the wages are unchanged. Overtime is compensated at time and one-half.¹⁸³

Additional holidays with full pay, not to exceed ten days per year, are designated by the Minister of Labor.¹⁸⁴ During pilgrimage season¹⁸⁵ the cities of Mecca, Medinah and Jeddah are virtually impassable.

Annual paid vacation of fifteen days for over one year of service and twenty-one days after ten years of continuous service are provided.¹⁸⁶ Additional leave is available with full pay on stated circumstances such as death of a family member or the worker's own wedding.¹⁸⁷

Sickleave at full pay is provided for the first thirty days of illness and at three-fourths pay for the next sixty days.¹⁸⁸ Women are entitled to compensation for all expenses of treatment and delivery for maternity plus a ten-week maternity leave at one-half pay after one year of service and at full pay after three years of service.¹⁸⁹

¹⁷⁶In 1975, Price Waterhouse estimated the average Saudi wages as follows: unskilled laborers — U.S. \$1,300 - \$1,500/year; skilled laborers — U.S. \$5,000 - \$6,000/year; clerks or secretaries — U.S. \$2,500 - \$3,000/year; financial managers and company executives — U.S. \$35,000 - \$40,000/year. The King recently announced a general salary increase of 25-50% for all government employees. Wall St. J., May 9, 1977, at 6, col. 1.

¹⁷⁷Labor and Workman Law, *supra* note 53, art. 123.

¹⁷⁸*Id.* art. 80.

¹⁷⁹*Id.* art. 45. The Minister of Labor may reduce this requirement temporarily if Saudi workers of the required technical skills or educational qualifications are unavailable. *Id.*

¹⁸⁰Government office hours are 7:30 a.m. - 2:30 p.m. Saturday through Wednesday. Royal Embassy of Saudi Arabia, Holiday Schedule for the Hijrah Year 1397 (1977) in Saudi Arabia [hereinafter cited as Holiday Schedule].

¹⁸¹Labor and Workman Law, *supra* note 53, art. 149.

¹⁸²Ramadan is a holy fasting month and, in 1977, ran from August 15 through September 14. Holiday Schedule, *supra* note 180.

¹⁸³Labor and Workman Law, *supra* note 53, art. 151.

¹⁸⁴*Id.* art. 155.

¹⁸⁵For 1977, the pilgrimage season runs from October 27 through December 7. Holiday Schedule, *supra* note 180.

¹⁸⁶Labor and Workman Law, *supra* note 53, art. 153.

¹⁸⁷*Id.* art. 159.

¹⁸⁸*Id.* art. 158. This requirement applies only to employers of more than twenty workers. *Id.*

¹⁸⁹*Id.* arts. 164, 166.

Provisions are included to protect workmen from work related hazards and diseases.¹⁹⁰ Plans for construction or alteration of projects using mechanical energy must be examined and may be modified by the Ministry of Industry and Electricity to ensure the safety of the workers.¹⁹¹ Particular protections are included for women and juvenile¹⁹² workers.¹⁹³

Additionally, the employer is required to furnish transportation for the workers from their places of residence or a given point of assembly to the place of work, medical facilities, and, if fifty or more workers are employed, a savings and thrift plan, recreational facilities and free nursery for children of female workers.¹⁹⁴

The employer may not materially alter the nature of work, reduce the employee's grade, convert an employee's monthly wage rate to shorttime or piece rate or relocate the employee so as to cause the employee serious difficulties without consent of the employee.¹⁹⁵

A worker terminated without valid reason or an employer whose worker resigns without valid reason from a labor contract of specified duration is entitled to indemnity as assessed by the "competent commission."¹⁹⁶ Labor contracts for unspecified periods may be terminated by either party on giving notice.¹⁹⁷ In the event the employer cancels a labor contract for an unspecified period or in the event a labor contract of a specific duration comes to an end, the employee leaves for call to military service, marriage or childbirth or as a result of some major force beyond his control, the employee is entitled to an award of one-half month's pay for each of the first five years worked and one month's pay for each subsequent year.¹⁹⁸ In the event the employee cancels the labor contract for an unspecified term by giving proper notice, he is entitled to a reduced portion of the above-stated award.¹⁹⁹

Dispute settlement is provided through either arbitration by mutual consent or through the use of the Labor and Settlement of Disputes Commissions.²⁰⁰ The disputes commissions are composed of

¹⁹⁰*Id.* ch. VII.

¹⁹¹*Id.* arts. 145, 146.

¹⁹²*Id.* art. 7. A juvenile is a person under age 15.

¹⁹³*Id.* ch. X. Protections include a prohibition of employment in hazardous industries or at nighttime.

¹⁹⁴*Id.* arts. 134-144. First aid facilities are required when fewer than 50 workers are employed, free physician, nurse and medicine when more than 50 workers are employed, and complete medical treatment including hospitalization and specialists when more than 100 workers are employed.

¹⁹⁵*Id.* arts. 78, 79.

¹⁹⁶*Id.* arts. 74, 83, 84.

¹⁹⁷*Id.* art. 73. Notice is thirty days for employees on monthly rate and fifteen days for all others. Indemnity equivalent to wages may be assessed in lieu of notice.

¹⁹⁸*Id.* art. 87.

¹⁹⁹*Id.* art. 88. He is entitled to the full award if the term of his service was at least ten years, two-thirds if over five years, and one-third if over two years.

²⁰⁰*Id.* arts. 172, 184.

a primary commission for hearings of first instance or arbitration enforcement and an appellate level called the supreme commission.

In addition to settling disputes, the commissions levy penalties as provided in the regulations for violation of the labor law.

Labor strikes are illegal; it is illegal for employees to do any act that may bring pressure to bear on the freedom of the employer.²⁰¹

The Social Security Regulations²⁰² establish a system of compensation for work related injuries, occupational diseases, temporary and permanent disability, unemployment, old age and death. The system is administered by the General Organization for Worker's Social Securities with offices in each district.²⁰³

The system applies to all employers of one or more workers²⁰⁴ and to all workers regardless of nationality, caste or age, provided their services are mainly performed inside of Saudi Arabia.²⁰⁵ However, foreign workers whose duration of work in Saudi Arabia will not exceed one year are excluded.²⁰⁶

The system is financed by joint contributions of employers and employees. The employee's share is five percent of his wages, and the employer's share is eight percent of the employee's wages. The employer may be assessed an additional two percent for workers engaged in "hazardous jobs" plus another two percent if the employer refuses to adhere to instructions issued by the authorities concerning the question of the safety and health of the workers.²⁰⁷

The employer is charged with responsibility for collecting the employee's share and with paying all amounts over to the General Organization within the first fifteen days of the end of the month for which the amounts are owed.²⁰⁸

The system compensates the party sustaining an industrial injury for the costs of medical care and provides daily allowances for incapacity and, in the event of death, pays funeral expenses and monthly stipends to the heirs.²⁰⁹ An industrial injury is any injury occurring as a result of the discharge of a duty or by the effect of work or by accident while the insured is traveling directly to and from work or meals and includes specified industrial diseases.

²⁰¹*Id.* art. 22. BUREAU OF LABOR STATISTICS, *supra* note 25, at 53.

²⁰²Social Security Regulations, enacted by Royal Decree of November 15, 1969.

²⁰³*Id.* art. 9. Technical assistance in administration has been provided by the U.S. Social Security Administration. U.S. DEPT. OF STATE, *supra* note 2.

²⁰⁴Social Security Regulations, *supra* note 202, art. 2.

²⁰⁵*Id.* art. 4.

²⁰⁶*Id.* arts. 5, 8.

²⁰⁷*Id.* art. 18.

²⁰⁸*Id.* art. 19. The penalty for late payment is 2% for each month or part thereof that the payment is late.

²⁰⁹*Id.* art. 28.

Additionally, reduced benefits are provided for incapacity or death not caused by industrial injury.²¹⁰ A retirement pension at age sixty is being phased in.²¹¹

The social insurance laws are the worker's sole remedy unless the injury was

deliberately created by the employer, or by his mistake, or as a result of his disregard of the [safety and health laws]. In these cases, the insured and his heirs shall retain all rights for compensation approved by other regulations in accordance with the Shari'ah Code of Laws.²¹²

The same shall be applied in the case of an injury caused by some third person. In such cases, the General Organization pays the worker and then is subrogated to his rights against the employer or third party.

Effect of U.S. Employment Laws

By express geographic limitation in the statute, the U.S. Occupational Safety and Health Act of 1970²¹³ does not apply to work performed in Saudi Arabia.²¹⁴

The Federal Unemployment Tax Act²¹⁵ does not apply to services performed outside of the U.S. and the employer is not assessed for the tax.²¹⁶

The Federal Insurance Contribution Act²¹⁷ does apply to services outside of the U.S. by a U.S. citizen employed by an American employer but does not apply to work performed by a Saudi national.²¹⁸

The foreign applicability of the Fair Labor Standards Act of 1938²¹⁹ and the Labor Management Relations Act of 1947²²⁰ is not clear. The statutes do not address the issue but the investor is advised to follow their guidelines in order to avoid possible problems.

The worker's compensation laws of individual states may purport to protect U.S. nationals working abroad, or even foreign nationals

²¹⁰*Id.* arts. 39, 40.

²¹¹*Id.* art. 38.

²¹²*Id.* art. 49.

²¹³29 U.S.C. §§ 651 *et seq.* (1970).

²¹⁴29 U.S.C. § 653 (1970).

²¹⁵26 U.S.C. §§ 3301 *et seq.* (1970).

²¹⁶26 U.S.C. § 3306(c) (1970). The act applies in limited circumstances if work is in connection with an American vessel or aircraft.

²¹⁷26 U.S.C. §§ 3101 *et seq.* (1970).

²¹⁸26 U.S.C. § 3121(b) (1970).

²¹⁹29 U.S.C. §§ 201 *et seq.* (1970).

²²⁰29 U.S.C. §§ 141 *et seq.* (1970). For one viewpoint on the possible extraterritorial application of the LMRA, see Northstern & Ayres, *The Multinational Corporation and the Extraterritorial Application of the Labor Management Relations Act*, 10 CORNELL INT'L L. J. 1 (1976), which asserts that LMRA provisions should be applied to relations between American employers and American employees abroad to the extent this does not conflict with the law and policy of the host country.

employed abroad by a domestic employer.²²¹ The investor should check all relevant worker's compensation statutes and obtain any necessary amendments to his insurance coverage.

Tax Law

The Islamic religion requires its followers to give each year 1/40th of their belongings to the poor and needy. Traditionally, religious leaders have collected this duty, or Zakat tax, for equitable distribution. When Saudi Arabia became a kingdom, the duty of collection fell to the King, as religious leader.

Zakat is now a direct tax paid annually by Saudi nationals and companies on income less certain deductions²²² and on capital resources other than fixed assets.²²³ A flat rate of two and one-half percent is imposed annually by the Department of Zakat and Income Tax.

Income tax is levied only against non-Saudi individuals and companies having non-Saudi capital.²²⁴ The basic income tax law consists of Royal Decrees issued in 1370, 1376 and 1380 as amended and amplified by over 100 published income tax circulars. The income tax laws are enforced by the Ministry of Finance through the Zakat and Income Tax Department.

Non-Saudi individuals are taxed on net income derived from the investment of capital in Saudi Arabia,²²⁵ however, income which an individual obtains from investment in a company will not be taxed to the individual if it has already been taxed as company profit.²²⁶ No distinction is made between ordinary and capital gains.²²⁷ Non-Saudi self-employed persons,²²⁸ professional people and craftsmen are taxed on their income.²²⁹ Otherwise, non-Saudi individuals are not taxed on their income.²³⁰

²²¹For example, North Carolina Workmen's Compensation Act entitles the employee to compensation under North Carolina law even when the accident occurs out of the state if the contract of employment was made within the state or if the employer's principal place of business is in North Carolina. N.C. GEN. STAT. § 97-36 (1973).

²²²GUIDE TO INDUSTRIAL INVESTMENT, *supra* note 47, at 46. Deductible expenses are similar to those discussed *infra* under income tax. For purposes of imposing the Zakat tax, however, losses may be carried forward.

²²³Examples of these resources include bank accounts and paid in surplus but do not include items such as industrial equipment.

²²⁴Income Tax Law, enacted by Royal Decree No. 17/2/28/576 of 14 Rabi'1, 1376 (1956). The reader is referred to Income Tax Regulations of Saudi Arabia, available from World Wide Enterprises, Ltd., Washington, D.C. 20005.

²²⁵Income Tax Law, *supra* note 224, art. 3.

²²⁶*Id.* art. 6.

²²⁷PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 10.

²²⁸OVERSEAS BUSINESS REPORTS, *supra* note 21.

²²⁹Income Tax Law, *supra* note 224, art. 8. This taxability may be limited to those professional people and craftsmen who are self-employed.

²³⁰Royal Decree No. 36/M of 4/5/1395 (1975).

Non-Saudi companies are taxed on income which has its source in Saudi Arabia.²³¹ The source of income is deemed to be within Saudi Arabia when either the location of the job, place of performance, or place of delivery is within Saudi Arabia.²³² Saudi companies with foreign capital are taxed on the share of taxable income allocable to the foreign capital.²³³

All companies must have an auditor who is deemed satisfactory by the Department of Zakat & Income Tax.²³⁴ The investor is cautioned to seek advance approval of all auditors not internationally recognized.

Either the cash or accrual methods of accounting is acceptable provided it is used consistently.²³⁵ With prior approval from the Zakat and Income Tax Department, the taxpayer may select his own accounting year.²³⁶ Additionally, a special short or long year may be elected when the activity in Saudi Arabia is commenced within an accounting year or when a contract is completed in a short period.²³⁷ The taxpayer may elect to consider his business in Saudi Arabia to have commenced either on the day the contract for work is signed or on the date work is commenced.²³⁸

All audit reports, financial statements and tax returns must be translated into Arabic before filing; as only the Arabic translation is official, the filing of an English version will not toll the deadline for filing.²³⁹ Tax returns for individuals, with tax payments, are due within fifteen days after the agreed year ends.²⁴⁰ Company returns with tax payments are due within two and one-half months after the agreed year ends and must be accompanied by audited financial statements.²⁴¹

Extensions for up to four months are granted for good cause shown but the extension must be requested and an estimated tax paid before the initial deadline. Estimated payments which underestimate the tax due by more than ten percent trigger the imposition of a fine from the date of the initial deadline.²⁴² Fines for late filing are strictly

²³¹Whinney Murray & Co., Notes of Income Tax — Saudi Arabia 8 (1977), PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 10.

²³²Zakat and Income Tax Department, Circular No. 1 of 1389 para. 3 (1969).

²³³Income Tax Law, *supra* note 224, art. 10. PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 6.

²³⁴There is no public accounting profession in Saudi Arabia and there are no formal procedures for recognizing foreign accountants. Internationally recognized auditors are acceptable. Income Tax Law, *supra* note 224, art. 16.

²³⁵PRICE WATERHOUSE & CO., DOING BUSINESS IN SAUDI ARABIA 32 (1975).

²³⁶Income Tax Law, *supra* note 224, art. 16.

²³⁷Zakat and Income Tax Department Circular No. 8 of 1381 (1962). This provision is especially useful because, as is discussed *infra*, losses may not be carried forward.

²³⁸Whinney Murray & Co., *supra* note 231, at 5.

²³⁹*Id.* at 3.

²⁴⁰PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 12.

²⁴¹*Id.* See *id.* at 24 for sample company tax return.

²⁴²Ministerial Decision No. 1/3/1 of 18/1/1392 (1972).

imposed; no excuses, are accepted absent prior approval as discussed above.²⁴³

When taxable income of a resident individual results only from net income derived from the investment of capital in Saudi Arabia, the first SR 10,000 is exempt from taxation.²⁴⁴ A resident self-employed or professional person or a craftsman is entitled to an exemption from taxation of the first SR 6,000 even though part of his income may have been derived from the investment of capital.²⁴⁵ The taxpayer who has been a resident for less than the full tax year is entitled to only a portion of the stated exemption proportionate to the period of his residence.²⁴⁶

Companies which are commonly controlled and engaged in similar activities are aggregated for income tax purposes.²⁴⁷ Companies dealing with the Saudi government may not be given exemption from taxation; although reimbursement for taxes paid may be arranged, the company must comply with normal reporting requirements.

There is no provision for net operating loss carry-forward or back, all loss not "used up" in the current year is lost.²⁴⁸ This provision may be quite significant to the investor anticipating heavy initial costs and should be considered in selecting an accounting year.

Construction contracts not completed within the accounting year are termed long term contracts. Income from such contracts for the accounting year is computed on the "sales value" of the work completed. The "sales value" is a percentage of the total value of the contract equal to the certified percentage of work completed, based on engineers' certificates.

In the event that different profit margins are expected for stages of the project falling in different years, the tax department may allow, on a case by case basis, an adjustment for expected future losses.²⁴⁹

²⁴³Whinney Murray & Co., *supra* note 231, at appendix D. The Director General of the tax department interprets the income tax decree to grant him no power to waive the fines. Fines are 10% of tax due for a late filing of over six days and 25% of the tax due if over 15 days.

²⁴⁴Income Tax Law, *supra* note 224, art. 5(2).

²⁴⁵*Id.* art. 5(1). This exemption has been increased since the Decree of 1376. PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 6.

²⁴⁶Income Tax Law, *supra* note 224, art. 5.

²⁴⁷Whinney Murray & Co., *supra* note 231, at 4.

²⁴⁸*Id.*

²⁴⁹PEAT, MARWICK, MITCHELL & CO., *supra* note 59, at 9. Because losses may not be carried forward or backward, the taxpayer could pay income tax on an overall loss. For example, if in year 1, the "sales value" is SR 75,000 and costs are SR 50,000, and in year 2, the "sales value" is SR 25,000 and the costs are SR 75,000, the taxpayer would suffer an overall loss of SR 25,000 but be taxed on "gains" of SR 25,000 (from year 1). However, the authorities have accepted an adjustment for long term contracts for example, by adjusting the year 1 "sales value" to an amount equal to the current actual costs, times the total contract value, divided by the total estimated cost of performance. On the above facts, the year 1 "sales value" would be adjusted to $SR\ 50,000 \times SR\ 100,000 \div SR\ 125,000 = SR\ 40,000$, for a year 1 reportable loss of SR 10,000.

A limited exemption exists for profits on foreign operations involving only the supply of materials to Saudi Arabia. This exemption is strictly construed and is completely eliminated if the supplier is deemed to carry on any business within Saudi Arabia (although the supply contract may be executed in Saudi Arabia). The mere delivery of materials within Saudi Arabia will constitute carrying on business; thus the supplier's obligations must terminate when or before his materials arrive at a Saudi port.²⁵⁰ Because of the possibility of levy against the purchaser for taxes due from a non-resident supplier,²⁵¹ the purchaser must concern himself that his supplier either strictly complies with this limited exemption or pays the necessary taxes.

The income tax law allows the following amounts to be deducted to determine the net profits of companies:

- A. All usual necessary expenses of commerce and business made during the year, including a reasonable amount for salaries of employees and for any payments made for any personal services.
- B. Traveling expense in connection with commerce or business.
- C. Rents of properties hired in connection with commerce or business.
- D. Any loss incurred from any commercial or business transaction on which there was no return or compensation.
- E. A reasonable amount for depreciation of properties used or employed in business operations.²⁵²

The tax department has distributed a list of allowable rates of depreciation for certain fixed assets but will consider the use of more rapid rates on proof of situations likely to cause abnormally rapid depreciation.²⁵³ Pre-operational costs may be written off over the shorter period of five years or the life of the project. Bad debts may be written off only after legal action has been taken against the defaulting debtor. Payments to the Saudi social security system may be deducted but not those amounts paid to the U.S. system. No deduction is allowed for indirect expenses (overhead) incurred in the operation of a head office outside of Saudi Arabia.²⁵⁴

Individuals are taxed on amounts in excess of the allowable exemption²⁵⁵ at a rate of five percent of the first SR 10,000, ten percent on the next SR 20,000, twenty percent on the next SR 30,000, and thirty percent on all greater amounts.²⁵⁶

²⁵⁰Zakat and Income Tax Department, Income Tax on Profits from Supply Operations, Circular No. 2 of 1389 (1969).

²⁵¹See text accompanying note 258 *infra*.

²⁵²Income Tax Law, *supra* note 224, art. 14.

²⁵³*Id.* art. 5. See, for summary of these rates, Whinney Murray & Co., *supra* note 231, at appendix C.

²⁵⁴Zakat and Income Tax Department, Regarding the Disallowance of Indirect Expenses as Deductions for Income Tax Purposes, Circular No. 3 of 1389 (1969).

²⁵⁵See text accompanying note 244 *supra*.

²⁵⁶Income Tax Law, *supra* note 224, art. 6.

Companies are taxed on their net profits at the rate of twenty-five percent of the first SR 100,000, thirty-five percent of the next SR 400,000, forty percent of the next SR 500,000 and forty-five percent of all greater amounts.²⁵⁷

Although withholding of tax is normally not required, in order to assist the tax department in collection of Zakat taxes, all companies must do the following:

1. Require each local subcontractor and supplier to submit certificates of satisfaction from the tax department attesting to payment of Zakat tax for the preceeding year;
2. Submit to the tax department annual lists of all payments made to local subcontractors and suppliers; and,
3. On request of the tax department, withhold payments to the local subcontractors and suppliers until certificates of satisfaction are issued.

Where the taxpayer deducts, in connection with services performed in Saudi Arabia, payments to non-resident companies as expenses, the tax department will seek to tax those payments as having a source within Saudi Arabia. Because the tax frequently cannot be levied on the non-resident company, the company claiming the deduction will be assessed for the tax under the fiction that the resident company is an "agent" for the non-resident company. In such a circumstance, a profit element is imputed at some percentage of the total payment. This percentage of imputed profit is imposed on an ad hoc basis by the tax department subject to a minimum of fifteen percent.²⁵⁸

The resident company is thus effectively made liable for the collection of income tax imposed on its non-resident suppliers and subcontractors. Accordingly, the resident company must protect itself by either withholding full payment of the contract price pending receipt of a certificate of satisfaction from the tax department or contractually accept liability for the taxes with appropriate alteration of the contract price.

Within seven days of receipt of a tax assessment, the taxpayer may file an appeal with the First Instance Committee which can review the assessment and refund taxes if required. Further appeal may be taken to the committee of appeal which operates under the chairmanship of the Ministry of Finance.

²⁵⁷*Id.* art. 11. These amounts have been increased since the Decree of 1376. PRICE WATERHOUSE & Co., *supra* note 235, at 35.

²⁵⁸Ministerial Decision No. 340 of 1370 (1951), art. 7. An imputed profit of fifteen percent is normally used for insurance premiums, bank charges and interest; twenty to thirty percent is common for most business activities and much higher rates are likely for consultants. Whinney Murray & Co., *supra* note 231, at 7.

Customs duties range from free to forty percent.²⁵⁹ Goods are classified according to the Brussels Tariff Nomenclature²⁶⁰ and are assessed on the amount converted to Saudi riyals at the time of acceptance of the bill of entry.²⁶¹ A surtax of five percent of the customs duty is the only additional tax levied on imports.²⁶² Customs duties are payable by contractors importing under government contract and thus should be considered in the bid price.²⁶³

The U.S. investor considering doing business in Saudi Arabia is concerned with the total tax burden on his profits. As has been discussed above, the profits will be taxed by the Saudi authorities to the extent they have a "source" within Saudi Arabia.²⁶⁴ Domestic corporations and resident individuals are subject to U.S. income taxation on income from any source, wherever located, but foreign companies are not taxed on income from a source outside of the United States.²⁶⁵ A domestic corporation or resident individual is not taxed on its interest in the profits of a foreign company until the profits are repatriated.²⁶⁶ A corporation is domestic to the United States if organized in the United States, or in one of its states or territories. All other corporations are foreign.²⁶⁷ To determine the total tax on an investment in Saudi Arabia, the interaction of Saudi and U.S. tax laws must be examined.

Saudi Arabia has no tax treaty with any country regarding the elimination of double taxation.²⁶⁸ Saudi Arabia offers an exemption from income taxation for a period of five years and an exemption from customs duties for approved investors.²⁶⁹ Saudi Arabia does not offer a foreign tax credit nor does it allow a deduction for foreign taxes paid.

²⁵⁹See text accompanying note 54 for possible exemptions. The individual rates for commodities may be obtained from Near East-South Asia Division, OIRE, Bureau of International Commerce, U.S. Dept. of Commerce, Washington, D.C. 20230. For example, foodstuffs are free, textile products are twenty to twenty-five percent, machinery at five to fifteen percent and transport equipment at five to thirty percent.

²⁶⁰OVERSEAS BUSINESS REPORTS, *supra* note 5.

²⁶¹PRICE WATERHOUSE & CO., *supra* note 235, at 19.

²⁶²OVERSEAS BUSINESS REPORTS, *supra* note 5.

²⁶³PRICE WATERHOUSE & CO., *supra* note 235, at 18.

²⁶⁴See text accompanying note 231 *supra*. A likely exception would be for the enterprise engaged solely in the supply of materials.

²⁶⁵26 U.S.C. §§ 1, 11, 881 (1970). The "source rules" are located at 26 U.S.C. §§ 861-864. See W. Gifford, INTERNATIONAL TAX PLANNING (1974).

²⁶⁶Important exceptions such as reallocation of income, 26 U.S.C.A. § 482 (West supp. 1977), controlled foreign corporation base company income, 26 U.S.C.A. §§ 951-964 (West supp. 1977), and foreign personal holding companies, 26 U.S.C.A. §§ 551-558 (West supp. 1977), should be examined.

²⁶⁷26 U.S.C. § 7701(a) (1970).

²⁶⁸Whinney Murray & Co., *supra* note 231, at 2.

²⁶⁹These exemptions and their limitations are discussed in text accompanying note 54 *supra*.

The U.S. tax law exempts certain foreign income from taxation in limited circumstances.²⁷⁰ A portion of the income of a domestic subsidiary corporation organized solely for the purpose of exportation may be deferred from taxation in certain circumstances if the subsidiary qualifies as a domestic international sales corporation (DISC).²⁷¹ U.S. citizens who maintain a residence in a foreign country for certain periods may qualify for part or all of their foreign earned income to be exempt from U.S. taxation.²⁷²

Otherwise, double taxation is avoided by use of a system of credits or deductions provided by the U.S. tax law. United States domestic corporations and resident individuals are allowed a credit against U.S. income tax with respect to income on which that corporation or individual has paid foreign income tax or its equivalent.²⁷³ Alternatively,²⁷⁴ a deduction may be taken for the foreign income taxes paid.²⁷⁵ Additionally, foreign real property taxes and taxes which are not income taxes but which are paid or accrued in carrying on a trade or business or in the production of income are deductible.²⁷⁶ Foreign taxes paid by a foreign company may not be taken as a deduction or credit by the U.S. resident individual owners of the foreign company but may under certain circumstances be taken as a credit or deduction by a U.S. domestic corporate owner.²⁷⁷ Consequently, the U.S. investor is fairly well protected from the possibility of being taxed twice on Saudi source profits.

Conclusion

The Saudi government is genuinely concerned with developing its country. Saudi Arabia is already a world economic power, yet the Saudi government is not amassing weapons in an effort to become a world military power. The royal family may best perpetuate itself at this stage by improving the status of its subjects.

Obviously a country controlling the world's largest reserves of oil is concerned with security. This is especially so in the troubled Middle East where Saudi Arabia feels threatened by radical Iraq and by Iran, whose weapon purchases have kept inverse pace with the depletion of their own oil reserves. Yet Saudi Arabia has resisted the temptation to

²⁷⁰Less developed country corporations are not discussed because of their effective repeal by the Tax Reform Act of 1976, 26 U.S.C.A. § 1248(d) (3) (West supp. 1977).

²⁷¹26 U.S.C. §§ 991-997 (Supp. V 1975).

²⁷²26 U.S.C.A. §§ 911, 912 (West supp. 1977).

²⁷³26 U.S.C.A. §§ 901 *et seq.* (West supp. 1977).

²⁷⁴Foreign taxes may not be taken as both a deduction and a credit. 26 U.S.C. § 275 (Supp. V 1975).

²⁷⁵26 U.S.C. § 164 (Supp. V 1975).

²⁷⁶*Id.*

²⁷⁷26 U.S.C.A. §§ 902 *et seq.* (West supp. 1977). See 26 U.S.C.A. § 78 (West supp. 1977) for possible adverse effects.

²⁷⁸PROGRESSIVE, April, 1977, at 44.

turn its petrodollars into weapons or an army. The Saudi government has instead looked to the United States for military protection in return for taking a moderate stance on OPEC price increases and continuing to pump far more oil than is economically wise.

Saudi Arabia is discovering the problems involved with administering development programs. In fact, Saudi Arabia has put the brakes on its ambitious five-year \$140 billion industrialization plan. Within a two week period of September, 1976 the Saudi government cancelled tenders and negotiations for several billion dollars worth of desalination plants and cancelled a proposed oil pipeline from southeastern Saudi Arabia to Dahrán. The Los Angeles based Fluor Corporation also felt the cutback as the Saudis extended the completion date from 1979 to the early 1980's for a four billion dollar gas gathering and treatment complex which the U.S. firm was building for Aramco.²⁸¹ A U.S. official stated that the Saudis were ironically a little short of cash because of an oil production slowdown and a number of outstanding bills coming due, [with another likely cause being the misgivings of powerful religious leaders balking at the large number of foreign workers rushed in to complete backed-up construction projects].²⁸² These obstacles are difficult to remedy because the Saudis are unable to import sufficient labor because of critical housing shortages but are unable to construct housing because of unavailability of labor and materials.

Additionally, the Saudis are wrestling with conflicting goals of keeping the number of foreigners to a minimum for traditional as well as sociological reasons while needing these foreign workers to train the Saudi workforce and to create the desired industrial development to leave Arabia with energy intensive, highly automated industries that require low levels of manpower. The Labor and Workmen Law²⁸³ reflects these conflicting goals by restricting the entry of foreigners to only those absolutely required and by requiring extensive training of Saudi workmen, each provision aimed at eventually leaving an industrial Arabia in the hands of the Saudis.

The result seems to be that while the Saudis are willing to pay the foreign investor handsomely, they require in return that the investor develop industries so that the country will not be left an empty shell

²⁷⁹The Saudi army has been estimated to be as small as 35,000 men. *TIME*, July 11, 1977, at 48.

²⁸⁰Saudi Arabia broke with OPEC on oil price increases in December 1976 and increased its production of crude oil. Recently, OPEC members' prices were again made uniform but at a lower level than would have been obtained absent Saudi intervention. *TIME*, July 11, 1977, at 48. Saudi Arabia is the number one supplier of overseas crude oil to the United States. *Wall St. J.*, March 30, 1977, at 28, col. 3.

²⁸¹*BUSINESS WEEK*, Sept. 20, 1976, at 35.

²⁸²*Id.* at 36.

²⁸³*Supra* note 53.

when all the oil is removed. Additionally, the investor is required to employ Saudi nationals under mandatory employment benefits and a generous social insurance program so that the wealth may be shared short of a welfare state. Training programs are required so that the Saudi nationals may eventually completely replace their foreign counterparts. Aramco has managed to reach a balance in this regard, and its U.S. shareholders have been immensely rewarded in terms of return on their investment as well as in continual excellent relations with the Saudi government. Consequently, the foreign investor is being offered a lucrative opportunity to enjoy the Saudi petrodollar but not at the expense of the Saudi people or culture.

